JULY 1992

A CAHNERS PUBLICATION

INDUSTRIAL DISTRIBUTION

THE MANAGEMENT AND SALES MAGAZINE FOR DISTRIBUTORS

EXCLUSIVE

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ID's ANNUAL SURVEY

Why your profits are disappearing

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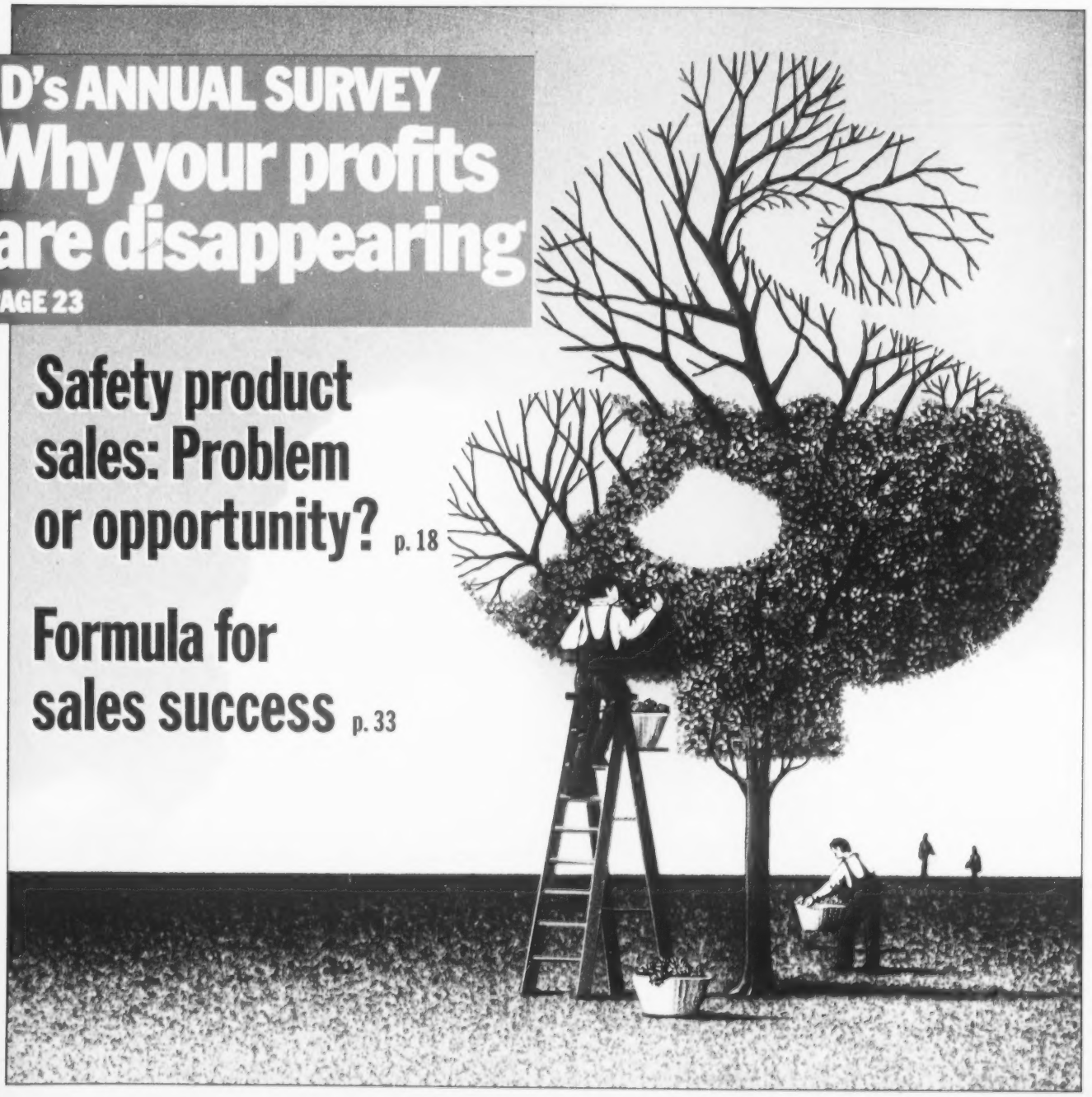
Formula for sales success p. 33



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1991 was a very difficult year to harvest profits.—p. 23

Find the right ingredients for your sales success formula.—p. 33

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INDUSTRIAL DISTRIBUTION

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EXCLUSIVE SURVEY

Why your profits are disappearing

Concerned about the industry's poor profit performance? ID's 46th Annual Survey of Distributor Operations provides some insight into how you can make your business more profitable.

OVERVIEW

'A world of opportunity awaits distributors who become low cost providers.'
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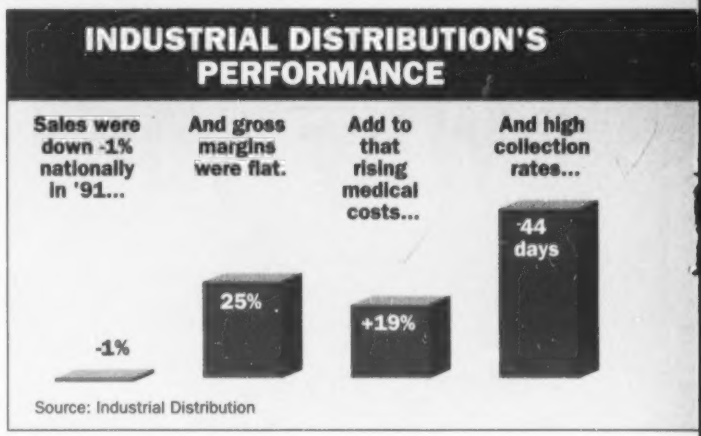
Theo Rudnak

OVERVIEW

Profit margins trimmed in '91

By Steve Zurier, Senior Editor

Distributors sold less product at slimmer gross margins in '91. Profits were flat too. But with the recession waning and more companies implementing TQM, '92 looks brighter.



What more can happen to industrial distributors? The end of the Cold War has left the defense market a mere shadow of its former self. Manufacturers continue to relocate offshore. Large distribution chains like W.W. Grainger, Kennametal and Sun Distributors maintain their aggressive postures. And many major customers demand more services at lower prices.

With all of these pressures, it should come as no surprise that 1991 was a less than banner year for distributors. In fact, many independents wonder privately why they are still in this business. A shrewder businessman might take the money and invest in mutual funds.

But while distributors agree that 1991 was a struggle, the *46th Annual Survey of Distributor Operations* reports that a solid 60% believe that their companies will experience sales growth in 1992. Why? They are convinced that distributors who implement the quality process, invest in technology and manage their assets more effectively are in a unique position to capitalize on end user vendor reduction programs.

True, a shakeout is ahead. But many distributors say that a world of opportunity awaits those who are willing to take on the challenge of becoming a low-cost provider. Only time will tell if they are right, or if they would have been better off putting their money in that mutual funds package.

The year in review

Anyway you slice it, 1991 was a year to forget. According to the *Survey*, distributor sales were down 1% nationally in '91, and gross profit margins were down to 25% from slightly more than 27% the year before. Add to that average collection rates of 44 days and a 19% jump in the cost of medical insurance, and you can quickly see why distributor profitability remained stagnant in 1991. For those interested in crunching the numbers, net profit before tax (as a % of total sales) was unchanged in 1991 as compared with 1990.

As you evaluate the *Survey*, keep in mind that the data represents input from distributors all across the U.S. While distributors in New England, Southern California and Long Island, N.Y., reel from the defense cuts, others based in Wisconsin, Nebraska and Minnesota report strong growth.

A quick look at the numbers finds that the Northeast took the biggest hit with a 12% decline in sales. The other two regions that suffered sales declines were the West at −4% and the North Central at −3%. The country's real bright spot was the Central region with a 13% sales gain, followed by the South and Southeast, which both experienced 8% growth. Taken by sales volume, the $1-4.99 million houses grew by 5%, the <$1 million firms were in the plus column, but just barely with a 1% gain, and the $5 million+ houses dropped by −.4%.

Given that a majority of the defense cuts were in the Northeast and West, it follows that those regions would have experienced negative sales growth. And the strong growth reported in the Central region is consistent with numerous reports of a resurgence in America's industrial heartland. In fact, one distributor in Nebraska reports that the farm implement and heavy equipment manufacturing industries kept his business ticking along last year while distributors in other regions bore the brunt of the recession. "Our sales were up 9.3% in 1991," says Allan Chartier of Midwest Industrial Tools in Omaha, Nebr. "And in the first quarter of 1992, sales were up 22%. We've got a buffer here that's not

And the profit growth picture was bleak.

0%

available to my colleagues on both coasts."

The real question

Now that we have the numbers, the real question is: What do they mean? In short, the *Survey* screams out loud and clear that profitability is tougher than ever to sustain. After finding similar results last year, we asked distributors if charging for value-added services was the main problem. Many agreed that it was. And as we reported in our May 1992 issue, distributors still have a long way to go before the value added question is under control.

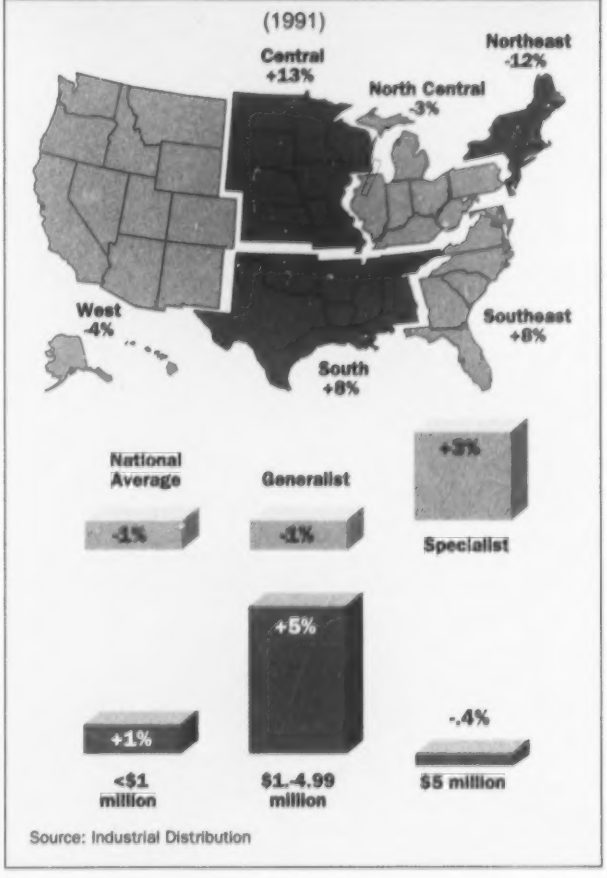
The underlying problem impacting distribution is that for the first time in its history, American manufacturers face global competition. No longer does America consume and produce more than 50% of the world's goods. And no longer does General Motors capture more than 50% of the North American car market. These factors, plus massive federal and personal debt have changed the game forever.

Without question, there are many negative forces conspiring against distributors. But it's not as if the Fortune 500 companies that distributors sell to have been rolling over and playing dead. Motorola, Xerox and yes, General Motors, have implemented quality programs that are turning American industry around. In looking to cut costs and gain efficiencies, these businesses depend on distributors to make them more productive. Now the good news: Many distributors *have* responded to the challenge with creative programs they never would have dreamed of implementing a few short years ago.

According to the *Survey*, 81% say they are forming stronger partnerships with their customers. And another 77% report that partnering programs are quite profitable. These partnerships take many forms. From PPG's Vendor City project in Lake Charles, La., to the Innovative Distribution Group's broad based partnering arrangement with Heidelberg Harris in Dover, N.H., industrial distributors are making a difference.

But as John Moore of Duncan Equipment Co. in Tulsa, Okla., points out, becoming a low cost provider with a value package means that distributors must expect their margins to shrink. "The reality is that distributors who move into these partnering programs must expect smaller margins," he says.

AVERAGE SALES BY BUSINESS REGION/TYPE/SIZE



Source: Industrial Distribution

"But if a distributor can cut down his operating expense through the quality process, he can expect his pre-tax net income to be higher. The worst move a distributor can make today is to evaluate his business by only its gross profit margins. The key is providing a total package of services at a lower cost."

John Moore's analysis makes sense. If you talk to 100 distributors, they'll all tell you a similar story: With the industrial pie shrinking, the name of the game in distribution today is grabbing market share from your competitors. How do you do that? By providing a value package at the lowest total cost.

The sad truth is that not everyone will survive. And many of the issues distributors cite, like the shrinking of the industrial base, are not new. Everyone knew that a shakeout was coming. But nobody predicted the end of the Cold War. The reality: If you think that the last five years brought change to the industry, stay tuned.

While it's not the complete answer to your business challenges, this year's *Survey* provides the best available snapshot into the minds of your colleagues. Read this article carefully. And if you thirst for more information, contact us at our Newton offices. The Editors of ID firmly believe that there are vast opportunities for industrial distributors who manage change. Having the foresight to empower your employees is a decision that comes from the heart. We can't make that one for you. But with the aid of the *Survey*, we can help you determine how your company measures up against the competition. It's time you knew.

Between the recession and the ongoing credit crunch, it's safe to say that merger mania didn't return to the distributor marketplace in 1991. Compared with 1988, when 56% reported being approached with an acquisition offer, 1991's 22% number is tame.

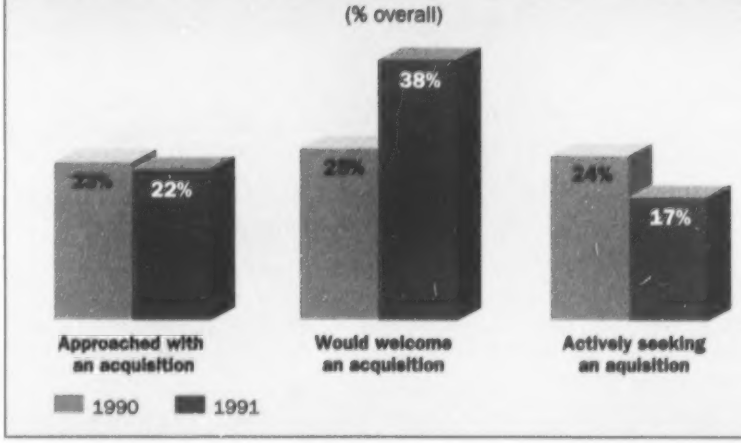
As you review the data for 1991, you'll find that while fewer distributors were approached with an acquisition offer, an astounding 38% say they'd welcome an offer. On top of that, 39% of the $1-4.99 million houses would welcome an offer, and 41% of the <$1 million firms say they are looking to sell.

But although nearly 40% say they would like to sell, they would only do so if they could get a premium price for their company. One Denver-based distributor says that most distributors believe that their businesses are worth more than what's on the books. But if distributors continue to report slim profits, what can they reasonably expect from the bankers when it comes time to sell?

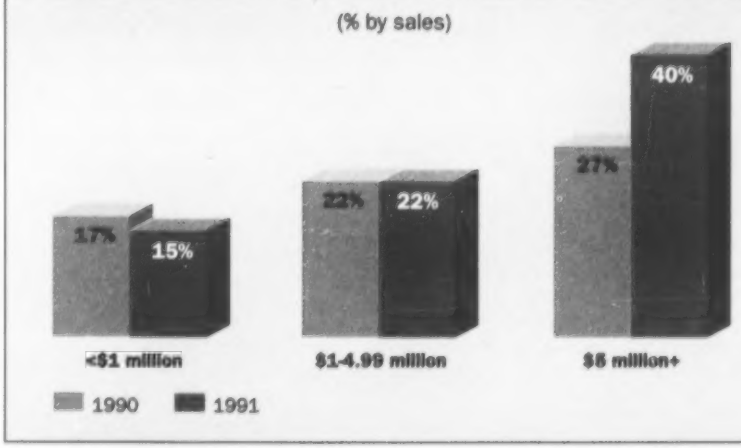
The issue of distributors approached with an acquisition is also worth a closer look. While the number of those approached with an offer remained flat, what's really interesting is that 40% of the $5 million+ houses were approached with an offer. This is up from 27% the year before. Compared with the 22% approached in the $1-4.99 million category and the 15% approached in the <$1 million category, it's clear that the buyers are interested in larger companies. Why? To gain market share. In fact, one Midwest distributor said he would only buy a smaller house if it operated in a sales territory he was interested in.

But if only 17% of those surveyed are looking to acquire another distributor, who's got the money? Answer: Overseas investors looking for a U.S. beachhead, and large firms already in the industry like Grainger. There are also U.S. investors looking to buy distributors. These investor groups believe that by hiring professional managers and applying new technology, they can run a chain of distributorships profitably.

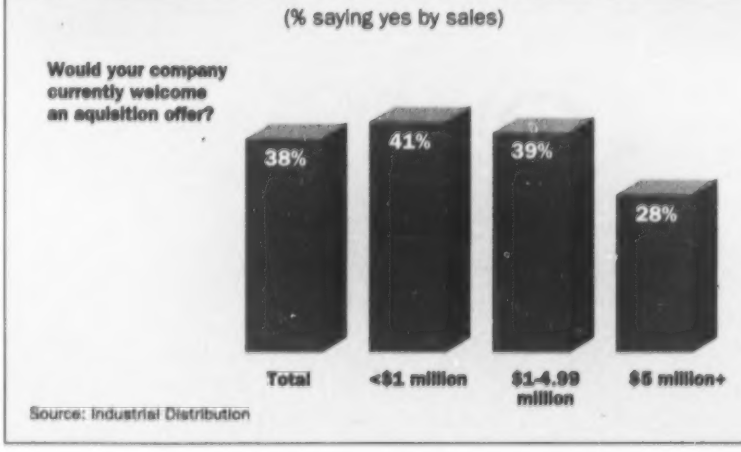
ACQUISITION ACTIVITY IN 1990/91



APPROACHED WITH AN ACQUISITION

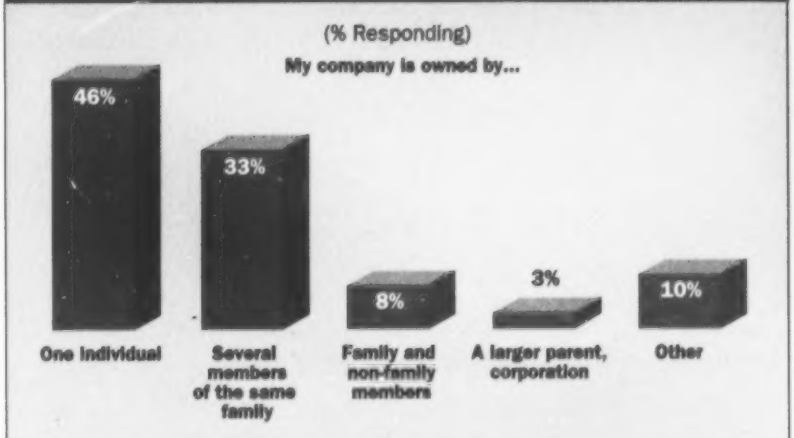


ARE YOU LOOKING TO SELL?



Source: Industrial Distribution

WHO OWNS AMERICA'S DISTRIBUTORSHIPS?



FAMILY OWNERSHIP

YEARS IN BUSINESS

Source: Industrial Distribution

Grainger, Sun and numerous other investment groups might have heady plans for the future. But until a lot more money changes hands, distribution will continue to remain an industry of closely-held, family-owned companies.

This assessment is backed up by the *Survey*, which found that nearly 88% of the companies polled are either owned by one individual, by several members of the same family, or owned by both family and non-family members.

The breakdown goes like this: About 46% are owned by one individual; 33% are owned by several members of the same family; and slightly more than 8% are owned by family and non-family members.

When you analyze the numbers by sales volume, it's clear that family-owned businesses dominate this industry, particularly the smaller houses. For example, slightly more than 54% of the <$1 million firms are owned by one individual, and 43% of the $1-4.99 million companies are owned by one person. But only 20% of the $5 million+ houses are owned by one individual.

What's not a surprise is that the smaller companies tend not to be owned by a parent corporation. While only about 2.5% of the <$1 million houses and slightly under 1% of the $1-4.99 firms were owned by a parent company, almost 8% of the $5 million+ houses were owned by a conglomerate. Experts keep telling us this will change, but the numbers say something different. The question remains: If distribution is so unprofitable, why do so many of them exist? In some ways, the scenario doesn't make sense.

One explanation is that some of these companies have been in business several years. While the average age of our group is 23 years, the $5 million+ firms have been in business an average of 37 years. The reality: Even with deep pockets, it's tough to knock off a competitor who has been calling on the same customers for 30 years. If you're not sure, ask Grainger and Kennametal about some of their experiences.

HEALTH CARE

Health care is an issue that won't go away. Costs keep rising. And there's an unsavory sense that an adequate solution simply doesn't exist. Distributors have felt the pinch in a big way. On average, health costs increased 19% for distributors last year. This follows a jump of slightly more than 18% the year before.

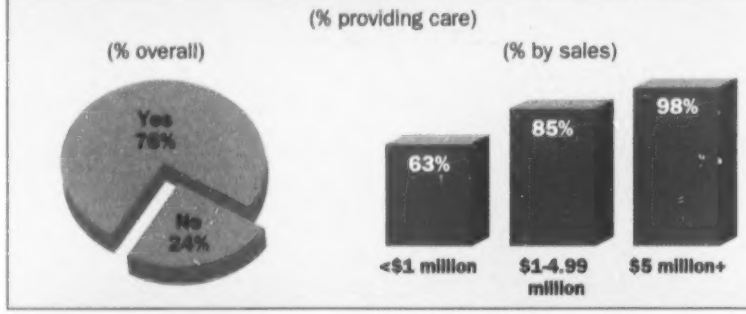
And in interviews with distributors across the U.S., it's clear that the data is accurate: Bob Bartholomew, president of Herlache Industrial in Green Bay, Wis., reports that his health costs jumped 25% a year for the last three years. Jay Abbott, president of M.L. Foss in Denver, Colo., adds that his costs have risen 52% during the same period. And John Moore, president of Tulsa, Okla.'s, Duncan Equipment Co., says his health care costs jumped a whopping 62% since January 1990.

Faced with staggering price increases, distributors are responding. According to the *Survey*, 32% asked employees to pay a greater percentage of their health care package last year, 8% changed suppliers and another 6% increased deductions.

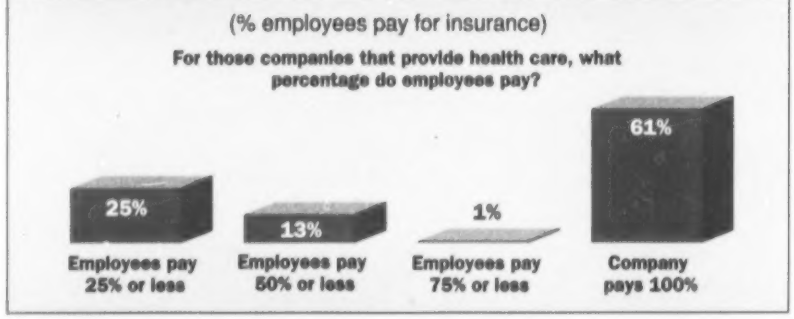
What does this say? It says that despite rising costs, distributors have bent over backwards to provide their employees with adequate health insurance. In fact, one distributor in the Nashville area says he wants the same quality health care for his employees as he has for his family. We're convinced that most distributors feel the same way. In fact, 76% provide their employees with health insurance. And 61% pay 100% of the cost.

Distributors clearly have some strong feelings on the health care issue. Despite a long tradition of conservative politics, almost 39% say they would support national health care. Broken down by sales, about 50% of the <$1 million houses support national care, and 31% of the $1-4.99 million firms say they'd support national health care. Only 20% of the $5 million+ firms support nationalized care.

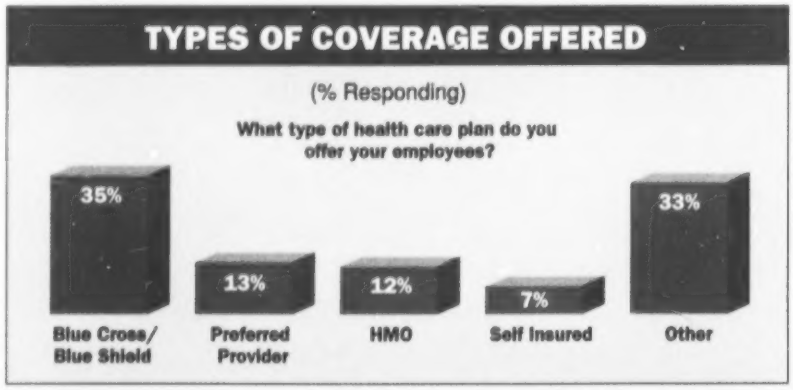
COMPANIES PROVIDING HEALTH CARE



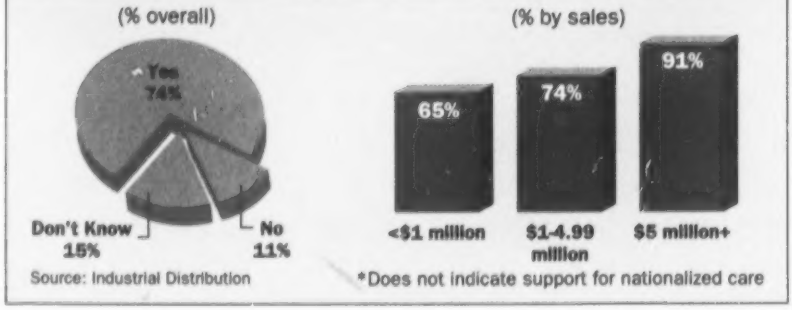
WHO PAYS WHAT?



TYPES OF COVERAGE OFFERED



DISTRIBUTORS SUPPORT REFORM*



Source: Industrial Distribution

*Does not indicate support for nationalized care

COMPUTERS

Distributors must grasp one simple fact: In an era of vendor reduction programs at many end users across the U.S., those distributors who write their purchase orders and quotations out by hand don't stand a chance.

While many distributors have taken advantage of computers, the view of the group as a whole is distressing. When asked if they needed to invest more heavily in computers during the next 10 years, 64% said no. Analyzed by sales, this means that only 40% of the $5 million+ houses agree that investing more heavily in computers is the way to go; 41% of the $1-4.99 houses say they must invest more of their resources in computers; and just 32% of the <$1 million firms believe investing in computers is necessary for survival.

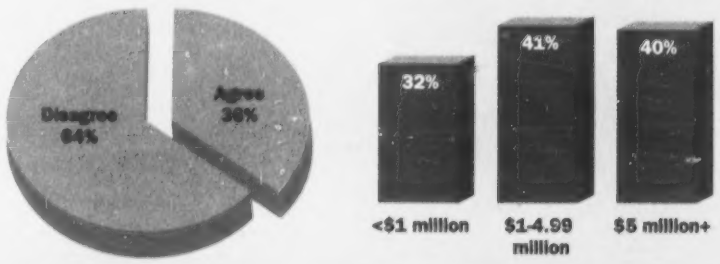
While these numbers may raise a few eyebrows, the real startling number is the relatively low percentage of distributors using computers, particularly at the smaller houses. Only 78% say their companies are computerized. Broken down by sales, 67% of the <$1 million distributorships are computerized; 81% of the $1-4.99 million companies have computers; and 100% of the $5 million+ companies use computers.

When asked what they use computers for, the bulk of respondents say they conduct accounting and payroll functions. Some samples: 94% use computers for accounts receivable; 88% for accounts payable; 83% have computers handle invoicing; and 82% use computers for inventory management.

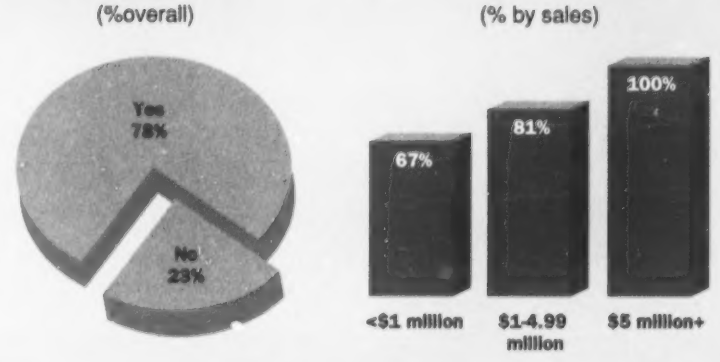
Digging deeper into the *Survey*, slightly more than 61% use minicomputers, and about 32% have mainframes. In addition, the distributors who use computers clearly haven't missed the personal computer revolution. According to the *Survey*, 72% of those who use computers operate their facilities with PCs. And the PCs are doing a wide variety of tasks: Almost 56% use PCs for promotional materials; 53% use them to mail labels; 50% have them generate documents; and 48% use PCs for direct mail programs.

VIEW OF DATA PROCESSING

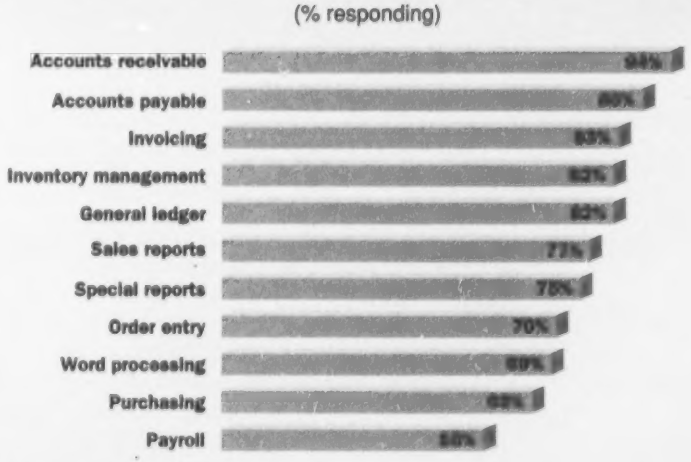
In order for my company to prosper in the next 10 years, my company should invest more heavily in computers.



COMPUTER USE



WHAT DISTRIBUTORS USE COMPUTERS FOR

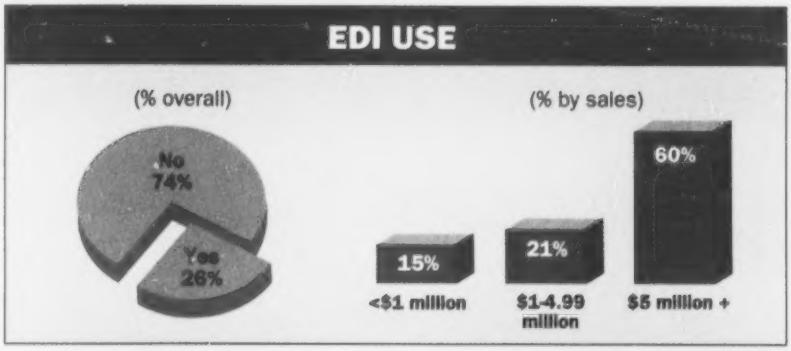


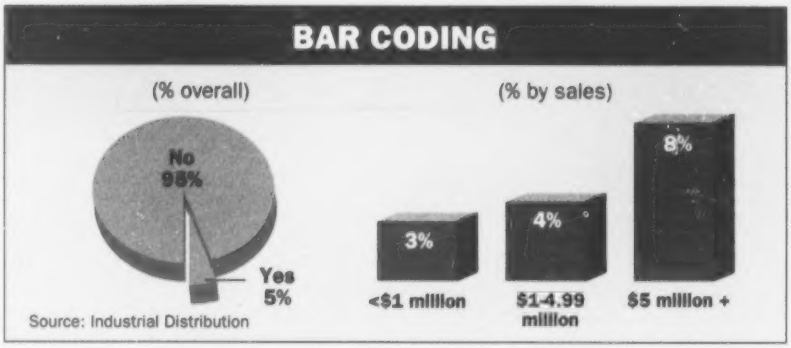
Source: Industrial Distribution

For computer buffs, the most distressing finding of the *Survey* is that distributors are still light years away from fully implementing EDI and bar coding.

According to the *Survey*, only 26% currently use EDI. And just 5% have implemented bar coding. But there's a stat that should scare the pants off the smaller houses. Nearly 60% of the $5 million + firms use EDI. Compare that with the 21% of the $1-4.99 million houses using EDI and the 15% of the <$1 million houses running EDI, and it's not hard to figure out who's in a stronger position.

When asked if their customers require them to implement EDI, more than 60% said yes. But based on the *Survey's* results, distributors are still holding back until their customers force them to modernize.





Important Facts About the Survey

Methodology

The data for this year's *Survey* was compiled by a research group hired by ID. Taking their lead from a questionnaire compiled by the Editors, the researchers conducted 403 telephone interviews, 201 with general liners, and 202 with specialty houses. The list included distributors from almost every segment of the industry, and every size and type. Companies were selected randomly from the magazine's subscription list.

Distributor types are defined as follows: Generalist (49.9%)—no one product category contributes 50% or more to total sales; and Specialty House (50.1%)—more than 50% of total sales comes from one major product category. We left out Combination Houses this year because we felt that general line and specialty distributorships were a more accurate reflection of our readership. Cahners Research estimates the *Survey's* margin of error as ±5%.

Medians and averages

Typically, the magazine article on the *Survey* reports data in both medians and averages. But for the sake of consistency, and because we believe the averages genuinely reflect industry performance, all of the information reported in this article are averages. The average is the sum of one group divided by its total number of respondents. Those interested in Median responses should order the full survey. Medians define the midpoint in a statistical range—half of any group will be larger than the median, and half smaller. Medians are generally used on open-ended questions, are often more representative of a group, and are less distorted by extremes.

How to order the Survey

The *46th Annual Survey of Distributor Operations* is a 100+ page report containing original statistics on general line and specialty industrial distributors. Operations are measured by type of firm, sales size, and by six geographic regions. Its contents are divided by sales and profits, gross margins, management, personnel, computers, and inventory and receivables. A special health care section is also included this year. The *Survey* costs $195 pre-paid. This price includes postage. Send your check to Diane Doucette, ID, P.O. Box 37, Boston, Mass. 02258, or call (617) 558-4346. ID

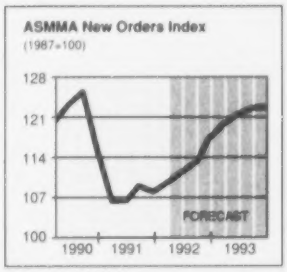
For reprint information, contact Katie Pyziak at (708) 390-2236.

By Susan E. Farris

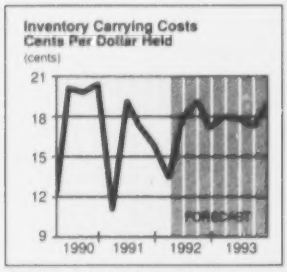
Recovery has finally arrived

Consumer durable goods will be one of the hottest markets in 1992.

In April, total industrial production posted the third straight month of growth, expanding 0.5%. It is clear from these gains in output that the economy is managing to sustain a recovery, albeit a very modest one. Industrial production is forecast to increase 2.5% in 1992. With both consumer spending and income levels higher relative to year-ago figures, rising demand for consumer durable goods is providing much of the strength in the economy. Consumer goods tend to be sensitive to interest rates, and therefore are among the first sectors to recover in an economic expansion. Industrial distributors can look forward to strong performances from their automotive, light truck and appliance end markets for the next two years.



Data source: ASMMA
Forecast source: Cahners Economics

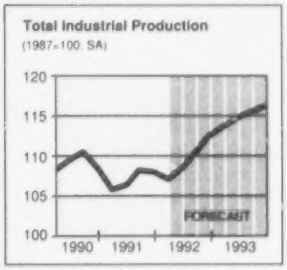


Data source: Cahners Economics
Forecast source: Cahners Economics

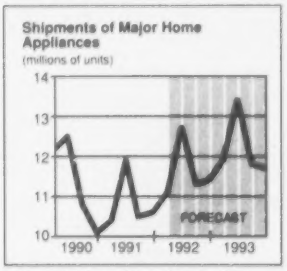
The auto industry, which has been plagued by weak demand for the past 3 years, is poised for a rebound in 1992. Last year sales of U.S. autos plunged 11%. While sales have been steadily rising since the beginning of 1992 on a year-to-date basis, sales are trailing by 7.4%. Auto production surged 4.1% during the month of April alone, indicating that automakers are gearing up in anticipation of a rebound in demand later this year. Sales of domestic autos are projected to grow 4.2% in 1992, which translates to some 6.4 million cars. The outlook calls for 1993 sales to rise 7.5%, the strongest growth since 1988.

Sales of light trucks have been growing faster than those for cars, and are in fact partly displacing demand for autos. As of the first quarter of 1992, light truck sales were trailing year-ago levels by just 0.7%. This compares to first quarter auto sales which were still considerably lower than they were a year ago. The forecast calls for sales of light trucks to surge 12% in 1992 and a further 13.6% by 1993. The light truck segment is approximately two-thirds the size of the auto market.

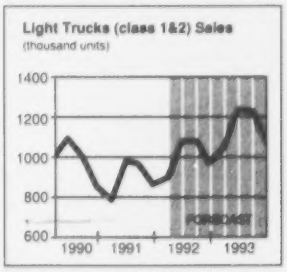
Major home appliance sales rose 0.5% over year-ago levels during the first quarter of 1992. Much of the demand is from the surge in housing starts, though growing consumer income, lower interest rates and pent-up demand are other factors behind the strong sales. The outlook for the appliance sector is good: Sales are forecast to increase 7.2% this year and 4.8% in 1993.



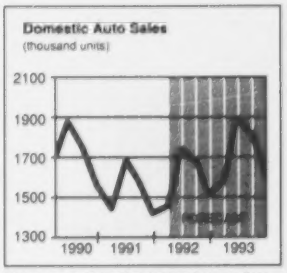
Data source: Federal Reserve Board
Forecast source: Cahners Economics



Data source: Assn. of Home Appliance Mfrs.
Forecast source: Cahners Economics



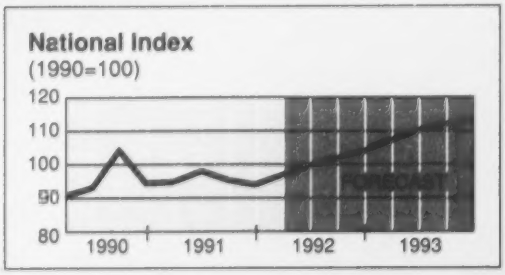
Data source: Motor Vehicle Manufacturers Assn.
Forecast source: Cahners Economics



Data source: Motor Vehicle Manufacturers Assn.
Forecast source: Cahners Economics

I.D.A. REPORT

SALES (1990=100)	Apr. 1992	Mar. 1992	Apr. '92 vs. Apr. '91 % change
TOTAL	100.0	102.1	+2.5
EAST	95.9	100.4	-1.6
SOUTH	110.4	106.4	+13.9
CENTRAL	98.2	103.2	-1.2
WEST	92.6	95.4	-5.9



SOURCE: Industrial Distribution Assn.